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96TH CONGRESS
2d Session

SENATE

REPORT
No. 96-1032

CERTAIN MISCELLANEOUS CHANGES IN THE TAX LAWS

COMPLETED

REPORT

ORIGINAL

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ON

H.R. 7171

NOVEMBER 24 (legislative day, NOVEMBER 20), 1980.—Ordered to be printed

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CERTAIN MISCELLANEOUS CHANGES IN THE TAX LAWS

NOVEMBER 24 (legislative day, NOVEMBER 20, 1980),—Ordered to be printed

Mr. LONG, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 7171]

The Committee on Finance, to which was referred the bill (H.R. 7171) to make certain miscellaneous changes in the tax laws, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendment is shown in the text of the bill in italic.

House bill.—H.R. 7171, as it passed the House, contains provisions relating to (1) an income tax exclusion for certain Federal scholarship grants, (2) the tax treatment of annuities purchased for employees of the Uniformed Services University of the Health Sciences, (3) the method of depreciation for railroad track assets, (4) the tax treatment of members of an affiliated group which included a transferor railroad in the ConRail reorganization, and (5) the excise tax treatment for wine and flavorings used in distilled spirits products.

Committee bill.—The committee bill (1) deletes the provision relating to Federal scholarship grants (similar provisions are included in H.R. 6975, as it passed the Senate), (2) retains the provision relating to the treatment of annuities purchased for employees of the Uniformed Services University of the Health Sciences, (3) deletes the provision relating to the depreciation of railroad track assets, (4) clarifies the provision relating to the treatment of certain net operating losses of a transferor railroad in the ConRail reorganization, (5) deletes the provision relating to wine and flavorings used in distilled spirits products (similar provisions are contained in H.R. 3317, as it passed the Senate), (6) adds a provision relating to the disclosure of tax returns to State audit agencies (section 6 of H.R. 4746, as it passed the House, and previously approved by the Senate, as section 3 of H.R. 3317), (7) adds a provision expanding the definition of lending or finance companies which are exempt from treatment as personal holding companies, and (8) adds a provision repealing the wagering excise taxes (previously reported by the committee in H.R. 3755).

I. SUMMARY

Section 1.—Tax Treatment of Annuities Purchased for Employees of the Uniformed Services University of the Health Sciences

Present law provides that, if an annuity is purchased for an employee by an exempt organization described in Code section 501(c)(3) or by a public school system, the employer's contributions for the annuity contract are excludable, within certain limitations, from the employee's gross income and are not subject to tax until the employee receives payments under the annuity contract.

This provision of the bill extends the same rule to qualifying annuities purchased for the civilian staff and faculty of the Uniformed Services University of the Health Sciences, which was established by the Congress under the Department of Defense to train medical students for the uniformed services.

Sections 2 and 3.—Tax Treatment for Members of an Affiliated Group which Included a Transferor Railroad in the ConRail Reorganization

Under present law, net operating losses of a member of an affiliated group of corporations controlled by a common parent corporation may be used to offset income reported by other members of the affiliated group where consolidated income tax returns are filed by the group. In order to reflect the reduction in tax liabilities derived by the other members of the affiliated group, the basis in the loss corporation's stock owned by other members of the group is reduced by these operating losses, and, where these losses exceed basis, a negative basis (called an excess loss account) is created. The excess loss account is restored to income when, for example, the loss corporation ceases to be a member of the affiliated group or the stock of the loss corporation becomes worthless.

The bill specifies that, for purposes of determining when an excess loss account is restored to income under the consolidated return rules, the determination of worthlessness of stock in a corporation which was a transferor railroad in the April 1, 1976, ConRail reorganization will not occur until after a final determination of the value of the transferred rail properties by a special court formed for this purpose. This provision is intended to benefit the Norfolk and Western Railway Company.

In addition, the bill provides that, to the extent an excess loss account arising from net operating losses of a ConRail transferor railroad from periods before or including the taxable year of the ConRail reorganization is restored as ordinary income (or its equivalent in capital gain income), the transferor's net operating losses will correspondingly be restored to the transferor railroad to apply solely against any income ultimately recognized by the transferor railroad

from the ConRail reorganization. This provision is intended to benefit the Erie Lackawanna Railway Company, and the Lehigh Valley Railroad Company.

Section 4.—Disclosure of Tax Returns to State Audit Agencies

Present law authorizes the disclosure of returns and return information to State agencies which are charged under the laws of the State with responsibility for the administration of State tax laws for the purpose of, and only to the extent necessary in, the administration of such law.

This section of the bill will allow State taxing authorities to disclose Federal tax return information in their possession to State auditing agencies for the purpose of auditing the activities of the State taxing authority.

Section 5.—Exemption of Certain Finance Companies from Personal Holding Company Treatment

Under present law, a tax is imposed on the undistributed personal holding company income of a personal holding company. Generally, personal holding company income includes interest. A corporation actively engaged in a lending or finance business is exempted from this tax if the corporation has qualifying business expenses equal to 15 percent of its ordinary gross income from its lending or finance business up to $500,000, plus five percent of such ordinary gross income from $500,000 to $1 million. The term "lending or finance business" does not include the business of making loans with remaining maturities of more than 60 months except in the case of certain secured obligations arising out of the borrower's or transferor's trade or business.

The bill increases the 60-month limitation of present law to 144 months, and amends the definition of a lending or finance business to include the business of making certain types of revolving credit loans. The bill also amends the business expense test of present law to require a lending or finance business to have qualifying business expenses equal to 15 percent of its ordinary gross income from the lending or finance business up to $500,000 plus five percent of such ordinary gross income in excess of $500,000. In other words, the $1 million ordinary gross income ceiling would be eliminated for purposes of applying the qualifying business expense test.

Section 6.—Exemption From Excise Tax on Wagers and Occupational Tax on Wagering

Under present law, a 2-percent excise tax is imposed on the amount of certain wagers. In addition, an annual $500 occupational tax is imposed on a person who is liable for the excise tax or who receives wagers subject to the tax. These taxes do not apply with respect to parimutuel wagering, a wager placed in a coin-operated device, or a wager in a State-conducted lottery.

The bill repeals the 2-percent excise tax on certain wagering and the annual $500 occupational tax on persons engaged in the business of accepting wagers. The provisions are effective January 1, 1981.

II. EXPLANATION OF BILL

A. Tax Treatment of Annuities Purchased for Employees of the Uniformed Services University of the Health Sciences (sec. 1 of the bill and sec. 403(b) of the Code)

Present law

If an annuity is purchased for an employee by an exempt organization described in Code section 501(c)(3) or by a public school system, the employer's contributions for the annuity contract are, within certain limitations, excludable from the employee's gross income and not subject to tax until the employee receives payments under the annuity contract (sec. 403(b)). Subject also to certain limitations generally applicable to tax-qualified retirement plans, the amount excludable in any year cannot exceed 20 percent of the employee's current annual compensation times the number of years of service, less amounts contributed tax-free in prior years.

In P.L. 92–426, Congress authorized establishment (under the Department of Defense) of the Uniformed Services University of the Health Sciences in order to train medical students for the uniformed services. This legislation authorizes hiring civilian faculty and staff members at salary schedules and with retirement benefits similar to those given to the faculty and staff of medical schools in the Washington, D.C. area. On July 15, 1975, the Secretary of Defense approved a tax-deferred annuity program for the faculty, similar to annuities available at certain medical schools in the Washington area and throughout the United States. However, because the University is a Federal instrumentality and is not an exempt organization described in section 501(c)(3), the annuities do not qualify under present law for tax deferral pursuant to section 403(b).

Reasons for change

The committee believes that annuities purchased for the civilian faculty and staff of the Uniformed Services University of the Health Sciences should qualify for income tax deferral in the same manner as annuities purchased for employees of exempt organizations described in section 501(c)(3) or of public school systems.

Explanation of provision

The provision treats otherwise qualified annuities purchased for the civilian staff and faculty of the Uniformed Services University of the Health Sciences in the same manner for income tax purposes (Code sec. 403(b)) as employee annuities purchased by section 501(c)(3) organizations or by public school systems. Any qualified annuity purchased by the University would be subject to the same limitations as other annuities described in section 403(b).

Effective date

The provisions apply to annuities purchased for service performed after December 31, 1979, in taxable years ending after that date.

Revenue effect

It is estimated that the provision will decrease budget receipts by less than $1 million per year.

B. Tax Treatment for Members of an Affiliated Group Which Included a Transferor Railroad in the ConRail Reorganization (secs. 2 and 3 of the bill and sec. 374 of the Code)

Present law

On April 1, 1976, a number of insolvent midwestern and eastern railroads, along with many of their subsidiaries and affiliates, transferred their railroad properties to the Consolidated Rail Corporation (ConRail). These transfers were mandated and approved by the Congress [1] in order to provide financially self-sustaining rail services in areas served by these bankrupt railroads.

Under the legislation which established it, ConRail, a taxable corporation, was to acquire, rehabilitate, and operate the railroad properties. The transferor railroads (and their subsidiaries and affiliates) received ConRail stock and certificates of value issued by the United States Railway Association, a nonprofit Government corporation formed to oversee the ConRail reorganization. Valuation of the transferred railroad properties, and the corresponding value of the certificates of value received by the transferor railroads, is to be determined ultimately by a special court created for this purpose.

In 1976, the Congress also enacted legislation to deal with certain of the tax consequences of this reorganization to ConRail, the transferor railroads, and the shareholders and creditors of the transferor railroads. Under this legislation,[2] the transfer of rail properties to ConRail was treated like reorganizations in general (and other bankrupt railroad reorganizations in particular) so that the transferor companies and their shareholders and security holders did not recognize gain or loss on the transfer and ConRail received a carryover basis in the properties it acquired (Code sec. 374(c)). In addition, where the carryover period has expired for a transferor railroad's net operating losses which were incurred before and during the taxable year in which the ConRail reorganization took place, these losses generally may be revived to apply against any income eventually recognized from the ConRail transfer (Code sec. 374(e)).

The 1976 tax legislation did not deal with certain other aspects of the ConRail reorganization, such as investment credit recapture to the transferor railroads which arose from the mandated transfer of assets to ConRail. To deal with this aspect of the ConRail reorganization, the Revenue Act of 1978 (P.L. 95–600, approved November 6, 1979) added an exception to the investment credit recapture rules so that a transferor railroad will not be subject to recapture of the investment credit because of its transfer of railroad properties to ConRail.

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[1] The facilitating legislation for the transfers was the Regional Rail Reorganization Act of 1973 (P.L. 93–236, approved January 2, 1974) and the Railroad Revitalization and Regulatory Reform Act of 1976 (P.L. 94–210, approved February 5, 1976).

[2] P.L. 94–253, approved March 31, 1976.

Present law also provides rules which deal with the filing of consolidated returns by affiliated groups of corporations.[3] Under the section 1502 consolidated return regulations, income tax liability generally is based on the combined income of the corporations in the affiliated group. Where one or more members of the affiliated group have incurred net operating losses, these losses offset taxable income of other members of the affiliated group, and the tax basis of their investment in the stock of the loss corporation is reduced, generally by an allocated portion (based on stock ownership) of the losses reflected in the consolidated return. If the losses used on the consolidated returns exceed the basis of the stock owned by the other members of the group, the result is the creation of excess loss accounts which are the equivalent of negative basis in the stock of the loss corporation owned by the other members.

Where there is a disposition of the loss affiliate's stock or the stock ownership requirements for an affiliated group cease to be met, any excess loss accounts in existence at that time are "restored" by treating them as income.[4] The term disposition is broadly defined and includes the occurrence of worthlessness of the loss affiliate's stock. In these situations, ordinary income will result to the extent of "insolvency" of the loss affiliate and special rules are provided for determining insolvency in situations concerning excess loss accounts. Where an excess loss account is restored, a previously used net operating loss is not restored to the loss affiliate.

Reasons for change

The committee believes that the question of the worthlessness of a ConRail transferor railroad's stock cannot be accurately resolved, for purposes of determining whether to trigger an excess loss account under the consolidated return rules, until the value of the consideration for the ConRail certificates of value is ultimately decided at some time in the future. In addition, the committee considers that, to the extent an excess loss account is triggered in connection with the net operating losses of a transferor railroad in the ConRail reorganization, the losses should be restored to apply against income eventually recognized from the ConRail transfers to the same extent otherwise expired net operating losses may be generally revived by a transferor railroad. The committee's bill addresses these two aspects of the ConRail reorganization.

Explanation of provisions

Determination of worthlessness of capital stock of a transferor railroad (Sec. 2 of the bill)

Section 2 of the committee's bill provides a statutory rule, for purposes of applying the consolidated return regulations, under which the determination of worthlessness of the capital stock of a transferor

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[3] These rules are primarily set forth in regulations promulgated under specific statutory authority (Code sec. 1502). An affiliated group of corporations is generally defined as a group of corporations connected with a common parent corporation through ownership of at least 80 percent of the voting power of all classes of voting stock and at least 80 percent of each class of nonvoting stock.

[4] These rules are necessary in order to reflect the reduction in tax liability which the other members of the affiliated group have derived through use of the losses.

railroad in the ConRail reorganization is postponed until a determination of value by the special court becomes final. Under this rule, where the question of whether there have been certain types of dispositions (called "deemed dispositions") of a ConRail transferor railroad's stock under the consolidated return regulations depends upon the determination of value by the special court, a deemed disposition will not be considered as occurring until the earlier of either the date the special court's determination becomes final or the occurrence of another event which causes restoration of the excess loss account under the consolidated return regulations. The committee intends that the specific types of deemed dispositions which are addressed by this provision are: (1) worthlessness of the stock of the transferor railroad and, (2) where 10 percent or less of the face amount of an obligation of the transferor railroad will be recoverable at maturity by its creditors, as these two types of deemed dispositions are described in Income Tax Regulations § 1.1502–19(b)(2) (iii) and (iv), respectively. As a result, the excess loss account will be restored before the special court's determination becomes final if, for example, the transferor railroad ceases to be a member of the affiliated group, or if another member of the affiliated group transfers an obligation of the transferor railroad to a nonmember of the group for 25 percent or less of its face value.

Section 2 of the bill is intended to benefit the Norfolk and Western Railway Company.

Net operating losses of a transferor railroad (sec. 3 of the bill)

In addition, under section 3 of the bill, it is provided that if an excess loss account arising from the net operating losses of a transferor railroad is restored to income of the affiliated group which filed consolidated income tax returns with the transferor railroad, those losses which are subject to the revival provisions generally under the ConRail reorganization will be restored to the transferor railroad in an amount which corresponds to the ordinary income (or its equivalent in capital gain income adjusted to reflect the lower capital gains rate) recognized by the affiliated group through triggering the excess loss account. For this purpose, an excess loss account will be considered to have been restored to income by the affiliated group even if an election is made to reduce basis in investments in the transferor railroad under the consolidated return regulations (Treas. Reg. § 1.502–19(a)(6)). (However, if such an election to reduce basis is made, the amount restored to the transferor railroad will be adjusted to reflect the lower capital gains rate.)

Because existing law concerning the revival of net operating losses by ConRail transferor railroads applies only to those losses incurred before or during the taxable year which includes the April 1, 1976, ConRail transfer, the net operating losses which are eligible for restoration to the transferor railroad under this provision are limited to those of the transferor railroad which contributed to the excess loss account and which were incurred either in the first taxable year which ends after March 31, 1976, or in a prior taxable year, and which could be carried over to the first taxable year which ends after March 31, 1976.

A first-in-first-out rule is also provided for purposes of this provision so that the restoration of the excess loss account will be considered,

for purposes of restoring net operating losses to the transferor railroad under this provision, to result from the earliest of the losses which created the excess loss account. The net operating losses which are restored may only be applied against income which is eventually recognized from the March 31, 1976, transfer to ConRail. In addition, where losses eligible for restoration to the transferor railroad are attributable to capital gain income recognized by other members of the affiliated group (through restoration of the excess loss accounts) these losses will be restored to the transferor railroad only in amounts equal to the ordinary income equivalent of these capital gains. The ordinary income equivalent of the capital gain is the capital gain multiplied by a fraction, the numerator of which is the capital gain tax rate of corporations for the taxable year in which the excess loss accounts were restored, and the denominator of which is the maximum rate of tax on ordinary income of corporations for this taxable year.

The provisions of section 3 of the bill can be illustrated by the following example. Assume that the basis of a transferor railroad's stock owned by the other members of the affiliated group had been reduced to zero at the end of 1974, because of prior losses used by the group, that the transferor railroad incurred net operating losses of $10 million in calendar year 1975, $20 million in 1976, and $15 million in 1977, and that in 1978 it had $10 million of income. Assume further that in 1979 the transferor railroad ceased to be a member of the affiliated group, and the excess loss accounts of the other members of the group, $35 million in total, are restored as ordinary income to the group. Because of the ordering rule in the bill, the $10 million of the transferor railroad's income in 1978 is deemed to offset its post-1976 loss. Accordingly, the full $30 million of losses which were incurred in 1975 and 1976 (and which increased the excess loss account) will be restored under the rules of the bill. In addition, if the transferor railroad is insolvent to the extent of $20 million at the time of the restoration of the excess loss accounts, the amount of the restoration of losses to the transferor would be $20 million plus 28/46 times $10 million, or a total of $26,086,956. This reflects the second aspect of the ordering rule, which attributes the ordinary income portion of the restoration to the earliest losses of the transferor railroad.

Section 3 of the bill is intended to benefit the Erie Lackawanna Railway Company, a member of the affiliated group of corporations of which the Norfolk and Western Railway Corporation is the parent corporation and the Lehigh Valley Railroad Company, a member of the affiliated group of which the Penn Central Company is the parent company.

Effective date

The provisions apply to deemed dispositions of a ConRail transferor's stock for taxable years ending after March 31, 1976, and to restorations after March 31, 1976, of excess loss accounts attributable to net operating losses of a ConRail transferor.

Revenue effect

The revenue effects of sections 2 and 3 of the bill are indeterminate with respect to both the amount of tax involved and the timing of tax payment.

If the excess loss account were restored to income for the 1976 tax year, the Norfolk and Western Railway Company would incur an additional tax liability of about $15 million. However, the amount of estimated tax liability, if any, may be adjusted after the determination of value by the special court. Because the taxpayer is expected to oppose assertion of a deficiency for its 1976 tax year, there would be an effect on budget receipts only if the taxpayer's position were not sustained and this occurred before the determination of the value by the special court became final or the Erie Lackawanna Railway Company ceased to be a member of the affiliated group of corporations of which the taxpayer is the parent corporation.

Restoration of the net operating losses to the Erie Lackawanna Railway Company could eventually decrease budget receipts by some amount of less than $15 million. However, these potential revenue losses are not expected to take place before fiscal year 1986.

The provision affecting the Lehigh Valley Railroad Company is estimated to reduce budget receipts by a total of less than $10 million. However, both the exact amount of the tax involved and the timing of the revenue losses are indeterminate.

C. Disclosure of Tax Returns to State Audit Agencies (Sec. 4 of the bill and sec. 6103(d) of the Code)

Present law

Under present law (Code sec. 6103(d)), returns and return information may be disclosed to State agencies which are charged under the laws of the State with responsibility for the administration of State tax laws for the purpose of, and only to the extent necessary in, the administration of such laws. Section 6103(d) sets forth specific rules with which a State agency must comply in order to receive Federal tax information. For example, the request for disclosure must be made by the head of the State tax agency in writing and the actual disclosure of the tax information may be made only to the representatives of the State tax agency who are designated in the written request to receive the information. Also, the law provides that the tax information cannot be disclosed to the Governor of a State. In addition, return information may not be disclosed to the extent that the Secretary of the Treasury determines such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation.

Return information disclosed to State agencies is subject to strict safeguard, recordkeeping, and reporting requirements (Code secs. 6103(p)(3) and 6103(p)(4)). These requirements provide assurances that Federal tax return information will be used only for the purposes authorized by law and provide a basis for determining when violations occur.

Reasons for change

The committee believes that a State taxing authority should be permitted to disclose Federal tax return information in its possession to a State audit agency for the purpose of auditing the State taxing authority.

Explanation of provision

The bill provides that any returns or return information obtained by a State agency pursuant to the provisions of section 6103(d) may be open to inspection by, or disclosure to, officers and employees of the State audit agency for the purpose of, and only to the extent necessary in, making an audit of the State agency which obtained the returns or return information. Under the bill, a "State audit agency" is defined as any State agency, body, or commission which is charged under the laws of the State with the responsibility of auditing State revenues and programs.

In addition, a State audit agency which receives return information would be subject to the same safeguard, recordkeeping, and reporting requirements as apply to other State agencies which receive return information and would be subject to the confidentiality requirements

imposed by section 6103(a) and the civil and criminal penalties applicable in the case of unauthorized disclosure of such return information.

Effective date

This provision is effective upon enactment.

Revenue effect

This provision will not have any impact on Federal revenues.

D. Exemption of Certain Finance Companies from Personal Holding Company Treatment (sec. 5 of the bill and sec. 542 of the Code)

Present law

Code section 541 imposes a 70-percent tax on the undistributed personal holding company income of a personal holding company. This provision is intended to prevent individuals from avoiding the graduated individual tax rates (ranging up to 70 percent) by placing investments in corporations which are subject to a maximum tax rate of 46 percent.

A personal holding company is defined as a corporation 60 percent of whose adjusted ordinary gross income is personal holding company income and 50 percent of whose stock is owned by 5 or fewer shareholders at any time during the last half of the taxable year. Personal holding company income generally is defined as interest, dividends, royalties, rents and certain other types of passive investment income.

Certain types of corporations which are actively engaged in a trade or business which produces income which usually would be considered to be passive investment income are excluded from the personal holding company tax provisions. Among the corporations excluded from these provisions are lending or finance companies. A corporation qualifies as a lending or finance company if 60 percent of its ordinary gross income is derived from the active and regular conduct of a lending or finance business and certain other requirements are satisfied. The term lending or finance business is defined, in part, to mean a business of making loans, and purchasing or discounting accounts receivable, notes, or installment obligations which at the date of acquisition have a remaining maturity of no more than 60 months. One exception to the 60-month rule is provided for loans, notes, or obligations secured by a security interest in personal property where the security interest arose out of the sale of goods or services in the course of the borrower's or transferor's trade or business.

The personal holding company provisions also apply a business expense test in determining whether a corporation is engaged in the active and regular conduct of a lending or finance business. Under this requirement a corporation will not qualify as a lending or finance company exempt from the personal holding company provisions unless the sum of its business expenses directly allocable to its lending or finance business equals or exceeds 15 percent of the first $500,000 of its ordinary gross income derived from a lending or finance busi-

ness plus 5 percent of such ordinary gross income from $500,000 to $1,000,000.[1]

Reasons for change

Since 1964 (when the rules relating to lending or finance companies were last amended) the nature of the loans made by lending or finance companies has changed. First, these companies have been making loans of longer maturities—primarily second mortgages on real estate and also financing of mobile homes. Some of these loans have maturities of up to 144 months. Notwithstanding the length of the loans, the making of these loans by these companies is often done not as part of an investment activity, but rather as part of the active conduct of a trade or business. Second, these companies have made increasing use of revolving credit loans, which technically may have a maturity which does not meet the "no more than 60 months" requirement. Furthermore, due to the passage of time, the cap on the business expense test has become outdated.

The committee also notes that the recent case of *Omaha Aircraft Leasing Co.*, 74 T.C. No. 19 (1980), involved the issue of whether the taxpayer was engaged in the active and regular conduct of a lending or finance business. In addresssing the issue of whether the "active and regular" requirement was met, the court considered (1) the number of loans outstanding, (2) the amount of effort and expense required to service the loans, (3) the extent of the taxpayer's activities involving attempts to make new loans, and (4) the duration of periods of inactivity by the taxpayer. The decision of the Tax Court in this case indicates that the "active and regular" requirement, coupled with the business expense test (as modified by the bill), should be sufficient to insure that the lending or finance company provisions will not apply to "incorporated pocketbooks" which are essentially passive investment entities even if loans with longer maturities are permitted.

Accordingly, the committee believes that the definition of the term lending or finance business should be modified to include the business of making revolving credit loans and loans with maximum maturities of 144 months and that the business expense test of present law should be modified by removing the cap.

Explanation of provision

The bill in general modifies the 60-month maturity limitation under the definition of a lending or finance business and the business expense requirement of the lending or finance company exception to the personal holding company provisions. Under the bill, the definition of a

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[1] Business expenses include only (1) deductions which are allowable only by reason of Code sections 162 or 404 and which do not represent compensation for personal services rendered by shareholders or members of their families and (2) deductions for depreciation and real property taxes to the extent that the property with respect to which such deductions are allowable is used directly in the active and regular conduct of the lending or finance business (Code sec. 542(d)(2)).

lending or finance business is amended to include the business of making loans with maturities up to 144 months and to include the business of making certain types of revolving credit loans.

Revolving credit loans qualifying under the bill would be such loans made under an agreement which provides that the creditor will make loans or advances (not in excess of an agreed upon maximum amount) from time to time for the account of the debtor upon request and which provides that the debtor may repay the loan or advance in full or in installments.

The bill also removes the current cap on the amount of business expenses required in determining whether a corporation is a lending or finance company. Under the bill, a corporation would satisfy the business expense test only if its qualifying business expenses equal or exceed 15 percent of its ordinary gross income up to $500,000 derived from a lending or finance business, plus 5 percent of such ordinary gross income in excess of $500,000.

Effective date

The provision applies to taxable years beginning on or after the date of enactment.

Revenue effect

It is estimated that this provision will reduce fiscal year budget receipts by less than $5 million annually.

E. Repeal of Excise Tax on Wagers and Occupational Tax on Wagering

(Sec. 6 of the bill and sec. 4402 and new secs. 4414 and 4415 of the Code)

Present law

Under present law, a 2-percent excise tax is imposed on the amount of certain wagers. For this purpose, a wager means (1) a wager placed with a person who is in the business of accepting wagers on the outcome of a sports event or contest, (2) a wager with respect to a sporting event or contest placed in a wagering pool conducted for profit, and (3) a wager placed in a lottery conducted for profit (including the numbers game, policy, and similar types of wagering). However, this excise tax is not imposed on (1) wagers placed with a parimutuel licensed under State law, (2) wagers placed in coin-operated gaming devices (e.g., slot machines) and (3) State-conducted wagering (e.g., State-conducted sweepstakes, off-track betting, and lotteries). Under present law, the 2-percent excise tax is imposed on so-called off-track betting authorized by State law but not conducted by the State.

Every person engaged in the business of accepting wagers is liable for the tax with respect to wagers on which the tax is imposed.

Under present law, a special occupational tax of $500 per year is imposed on each person who is liable for the 2-percent excise tax on wagers and on each person who is engaged in receiving wagers for such a person.

Reasons for change

The committee believes that the present law excise tax, which applies to certain types of wagering but not to others, discriminates unfairly among different types of legal wagering. The committee also believes that the imposition of taxes subjects legal wagering to an unnecessary economic burden not borne by illegal wagering for which such liabilities are generally evaded. Therefore, the bill eliminates the wagering excise and occupational taxes.

Explanation of provision

The provision repeals the 2-percent excise tax on wagers and the annual $500 occupational tax on persons engaged in the business of accepting wagers.

Effective date

The provision applies to any wager made, or any person engaged in receiving any wager, during taxable periods beginning after December 31, 1980.

Revenue effect

It is estimated that this provision will reduce fiscal year budget receipts by $9 million in 1981, $14 million in 1982, $15 million in 1983 and 1984, and $16 million in 1985.

III. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL AS AMENDED

Budget Effect

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made about the effect on the budget of this bill, H.R. 7171, as amended. The committee estimates that the bill will reduce budget receipts by $13 million in fiscal year 1981, $18 million in fiscal year 1982, $19 million each in fiscal years 1983 and 1984, and $20 million in fiscal year 1985.

The Treasury Department agrees with this statement.

New Budget Authority and Tax Expenditures

In accordance with section 308 of the Budget Act, after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority or new or increased tax expenditures.

Consultation with Congressional Budget Office on Budget Estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated above) and agrees with the methodology used and the resulting revenue estimates.

Vote of the Committee

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the following statement is made about the vote of the committee on the motion to report the bill, as amended. The bill, H.R. 7171, as amended, was ordered favorably reported by voice vote.

IV. REGULATORY IMPACT OF THE BILL

In compliance with paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the regulatory impact that might be incurred in carrying out the provisions of this bill, H.R. 7171, as reported by the committee.

Individuals and businesses regulated and economic impact of regulation.—The bill does not regulate any individuals or businesses, but amends certain provisions of the tax law. The bill repeals the 2-percent excise tax on certain wagers and the annual $500 occupational tax on persons in the business of accepting wagers. Thus, the bill eliminates the economic impact of these taxes.

Impact on personal privacy.—The provisions of the bill will have minimal impact on personal privacy.

Determination of paperwork involved.—The provisions of the bill will reduce the excise tax reporting and other paperwork of persons involved in wagering by repealing the 2-percent wagering excise tax and the $500 annual occupational excise tax.

V. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, H.R. 7171, as reported by the committee).

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